

Decision **PROPOSED DECISION OF ALJ FARRAR** (Mailing 1/10/2013)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California-American Water Company (U210W) and Garrapata Water Company (U212W) for an Order Authorizing Garrapata Water Company to Sell and California-American Water Company to Purchase the Assets of Garrapata Water Company.

Application 12-05-010
(Filed May 8, 2012)

DECISION APPROVING APPLICATION OF CALIFORNIA-AMERICAN WATER COMPANY'S ACQUISITION OF GARRAPATA WATER COMPANY ASSESTS

1. Summary

Today's decision authorizes the Garrapata Water Company (Garrapata) to sell, and the California-American Water Company (Cal-Am) to purchase, the public utility assets of Garrapata. In approving this sale we relieve Garrapata of its public utility obligations, establish Garrapata's current rates for water service as Cal-Am's rates for customers in Garrapata's service territory until Cal-Am's next general rate case, establish a rate base for the acquired assets consisting of the cash price paid for the assets plus the transactional costs associated with the acquisition, expand Cal-Am's service territory in Monterey County (to permit it to provide public utility water service to the current customers in Garrapata's service territory), and expand Cal-Am's certificate of public convenience and necessity.

2. Background

On May 8, 2012, the California-American Water Company (Cal-Am) and the Garrapata Water Company (Garrapata) filed the above application with the California Public Utilities (Commission) for an order authorizing Garrapata to sell and Cal-Am to purchase the public utility assets of Garrapata. The Application also asks the Commission to: (1) relieve Garrapata of its public utility obligations, (2) expand Cal-Am's certificate of public convenience and necessity (CPCN), and its service territory in Monterey County to permit it to provide utility water service to the current customers in Garrapata's service territory, (3) establish Garrapata's current rates for water service as Cal-Am's rates until its next general rate case (GRC), and (4) establish a rate base for the acquired assets consisting of the cash price paid for the assets plus the transactional costs associated with Cal-Am's acquisition.¹

On June 7, 2012, the Division of Ratepayer Advocates of the California Public Utilities Commission (DRA) filed a protest to the Application. DRA objected chiefly on the grounds that the Application lacks information on future rates for Garrapata customers after Cal-Am's acquisition of Garrapata's assets, and that Cal-Am proposed to include in the rate base for the acquired assets Cal-Am's transactional costs of acquiring Garrapata's assets.

Cal-Am responded to DRA's protest on June 19, 2012, and representatives of the parties met to discuss DRA's concerns on June 21, 2012. On June 25, 2012 DRA withdrew its protest and on August 21, 2012, Cal-Am and DRA filed a joint

¹ The precise amount of the rate base for the acquired assets is to be established in Cal-Am's next GRC for rates that will be effective in January 2015.

stipulation showing that DRA's concerns were addressed and urging approval of the Application by the Commission.

3. Discussion

3.1. The Proposed Transaction

3.1.1. The Parties

Garrapata, a California corporation, is a Class D public utility water company regulated by the Commission. Garrapata's service territory is in Monterey County, generally along Highway 1, south of the Carmel Highlands, beginning at the Garrapata Bridge and continuing south to the Rocky Point Restaurant. Garrapata provides drinking water to approximately 49 non-metered residential service connections in this area.

Garrapata is designated as a surface water system by the Monterey County Health Department because it utilizes the underflow from Garrapata Creek. Two wells produce the drinking water from this supply source, although only one well is currently active. Other principal components of Garrapata's water system include four storage tanks (two of which were replaced in 2011 with the proceeds of a grant from the California Department of Public Health), a new transmission line and a Strainrite bag surface water treatment system consisting of three sets of pre- and post-filter bags, a influent and effluent turbidimeter, and a chlorination system for the disinfection and inactivation of Giardia, Cryptosporidium, and viruses.² The Garrapata water system is currently operational, and since June 2011 has been operated by Cal-Am pursuant to a contract with Garrapata.

² A full description of Garrapata's plant, systems and property is on file with the Commission in Garrapata's 2011 Annual Report to the Commission.

Cal-Am, a California corporation, is a Class A public utility water and sewer company regulated by the Commission. Cal-Am provides regulated water and sewer system utility service in various parts of San Diego, Los Angeles, Ventura, Monterey, Sonoma, Sacramento, and Placer counties. Cal-Am is an experienced water and sewer system operator in Monterey County. Cal-Am currently serves over 100,000 residents through 42, 817 service connections in Monterey County, including service areas in Carmel Valley, Carmel, Pacific Grove, Monterey, Seaside, Ambler Park, Bishop/Pasadera, Ryan Ranch Chualar, Toro, Hidden Hills and Ralph Lane.³

3.1.2. Assets and Liabilities

Garrapata and Cal-Am (Applicants) have entered into an Asset Purchase Agreement (Agreement) pursuant to which Garrapata will sell, and Cal-Am will purchase, all of the assets that comprise the Garrapata water system, including all wells, storage tanks, water treatment equipment, mains, distribution lines, real estate, easements, rights of way, appropriative water rights, and other facilities necessary to provide domestic water service in Garrapata's service territory.⁴

The Agreement provides that the purchase price for Garrapata's assets shall be \$50,000. In addition to the purchase price, Cal-Am will assume the State Revolving Fund (SRF) Loan from the California Department of Public Health currently held by Garrapata in the amount of approximately \$114,000. The SRF

³ A full description of Cal-Am's plant, systems and property is on file with the Commission in Cal-Am's 2010 Report to the Commission.

⁴ A copy of the Agreement was included as Exhibit 2 to the Application and by letter dated October 5, 2012, Cal-Am Documented the completion of its pre-closing obligations.

loan, along with a customer surcharge to repay and service the loan, was authorized by Commission Resolution W-4788, on September 24, 2009.

3.1.3. Continuing Water Service to Garrapata Customers

Applicants state that after the sale of the assets of the Garrapata water system, Cal-Am will assume the sole obligation of operating the system and providing public utility water service to the current customers in Garrapata's service territory and that the Garrapata system will be incorporated into Cal-Am's Monterey District. Cal-Am requests authorization to retain the current rates for water service authorized in Garrapata's current tariff until a decision is rendered and effective in Cal-Am's next GRC.⁵ Applicants therefore request that, in addition to approving the sale and purchase of Garrapata's assets, the Commission order also: 1) Relieve Garrapata of its public utility obligations, 2) authorize the expansion of Cal-Am's CPCN and its service territory in Monterey County to include service to the current customers in Garrapata's service territory, and 3) establish Garrapata's current rates for water service as Cal-Am's rates until new rates are adopted in Cal-Am's next general rate case for rates to be effective in 2015.

⁵ Cal-Am states that it expects to request that rates for the Garrapata system be set based on some sort of consolidation of cost of service with other portions of the Monterey District in its next GRC.

3.1.4. Asset Consideration

Applicants have agreed on a purchase price for Garrapata's assets of \$50,000. The purchase price is slightly less than the current rate base of \$57,407 set for Garrapata in Commission Resolution No W-4874 on April 14, 2011. In addition to the purchase price, Cal-Am will assume the SRF Loan from the California Department of Public Health currently held by Garrapata in the amount of approximately \$114,000. In accordance with Commission practice, Applicants do not ask that this loan become a part of the rate base of the acquired assets if the application is approved.

3.2. Ratepayer/Garrapata Customer Benefits

Applicants assert that Cal-Am's acquisition of Garrapata's assets will produce several ratepayer benefits. First, Applicants assert that Garrapata's customers will benefit from improved water quality as a result of the proposed transaction. In addition to considerable experience with supply sources similar to those in the Garrapata system, Cal-Am employs a large staff that includes water treatment operators, distribution operators, and supervisors and superintendents that are certified through the California Department of Public Health. Applicants note that since Cal-Am assumed control over operations and maintenance of the Garrapata system in June 2011, it has resolved Garrapata's water quality problems and had lifted the 10-year old boil water order issued by the Monterey County Department of Environmental Health. Applicants further assert that Garrapata customers will benefit from reduced operating costs associated with efficiencies and economies of scale. In particular, as a subsidiary of American Water, Cal-Am customers benefit from national bulk pricing for chemicals, meters, pipes, and other equipment, and have access to a centralized call center, a dedicated water testing laboratory, and less-expensive capital.

3.3. Proposed Ratemaking Treatment

Cal-Am is requesting a rate base determination for the acquired Garrapata assets consisting of the cash price paid for the assets plus Cal-Am's transaction costs.⁶ When the transaction costs are added to the purchase price, the requested rate base exceeds Garrapata's Commission approved rate base of \$57,407.⁷

Cal-Am makes several arguments in support of the requested rate base. According to Cal-Am, the requested rate base will reflect the expected net utility plant in service following the close of the transaction, as well as all other adjustments, such as working capital, advances, contributions, and book depreciation. Cal-Am also notes that it has agreed to assume most if not all of the transaction costs, including costs that would usually be the responsibility of the seller. According to Cal-Am, if Garrapata had assumed these transaction costs Garrapata would have requested a larger purchase price to cover them.

More generally, Cal-Am argues that while the requested rate base exceeds Garrapata's current rate base, the Public Water System Investment and Consolidation Act of 1997 (the Consolidation Act), Decision (D.) 99-10-064, and Public Utilities Code Section 2720(a) justify including the difference between the current rate base and the fair market value of the assets in rate base. In

⁶ The transaction costs, which include legal fees associated with the transaction, surveying and mapping activities, and other cash outlays by Cal-Am, are estimated to add \$50,000 to the purchase price. Because some transaction costs cannot be accurately determined before the sale and purchase is consummated, Cal-Am requests that the exact amount of the rate base for the acquired assets be determined as part of its next GRC with the rates to be effective in 2015.

⁷ The \$50,000 cash purchase price plus the transaction costs equate to a requested rate base of approximately \$100,000. The total rate base will exclude the \$460,000 bag filtration system that was sourced through contributed funds.

particular, Cal-Am notes that the Consolidation Act was intended to facilitate the acquisition of small troubled water systems by Class A water utilities such as Cal-Am, that D.99-10-064 sought to “aid water systems in making infrastructure improvements, ... and to provide water corporations with incentives to achieve economies that benefit ratepayers,” and that Section 2720(a) provides that:

In determining whether the additional amounts are fair and reasonable the Commission shall consider whether the acquisition of the public water system will improve water system reliability, whether the ability of the water system to comply with health and safety regulations is improved, whether the water corporation by acquiring the public water system can achieve efficiencies and economies of scale that would not otherwise be available, and whether the effect on existing customers of the water corporation and the acquired public water system is fair and reasonable.

Consistent with Section 2720(a) we must balance the desirability of the transfer of Garrapata to Cal-Am with the rate impact on the relatively small number of Garrapata customers. While we hesitate to approve the transaction without knowing what the exact cost will be to ratepayers, we will grant Cal-Am’s request that the exact amount of the rate base for the acquired assets be determined as part of its next GRC, with the rates to be effective in 2015, but we will also require that the increase in rate base due to the inclusion of transaction costs not exceed the amount of such costs estimated by Cal-Am in this Application.

3.4. Compliance with California Environmental Quality Act (CEQA)

Rule 2.4 of the Commission’s Rules of Practice and Procedure require applications to address the potential environmental impacts of the transactions for which approval is sought. Here, Applicants assert that the sale and purchase of Garrapata’s assets is not an activity subject to the CEQA because the sale and

purchase at issue will not result in a “direct or reasonably foreseeable indirect physical change in the environment,” as those terms are defined in CEQA and the CEQA Guidelines. In D.97-07-019 we determined that a regulated utility’s sale of land will not cause any direct physical changes in the environment and that a change in ownership of a utility “does not [by itself] cause any direct physical change in the environment.” (D.98-02-026 at 3.) Because there will be no change in the way Cal-Am utilizes the Garrapata assets after consummation of the proposed transaction no “direct or reasonably foreseeable indirect physical change in the environment” will occur as a result of the proposed transaction, therefore the transaction is not subject to the provisions of CEQA.

3.5. Conclusion

For the reasons set forth above, we will approve Cal-Am’s acquisition of Garrapata pursuant to the terms set forth in the Agreement and the limitation set forth herein.

4. Categorization and Need for Hearings

In Resolution ALJ 176-3294 dated May 24, 2012, the Commission preliminary categorized this application as Ratesetting, and preliminary determined that hearings were necessary. No hearings are required due to the withdrawal of DRA’s protest and therefore, the hearings determination is changed to state that no evidentiary hearings are necessary.

5. Assignment of Proceeding

The assigned Commissioner is Catherine J.K. Sandoval and the assigned Administrative Law Judge is Darwin E. Farrar.

6. Reduction of Comment Period

In light of DRA's having withdrawn its protest, this is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Section 311(g)(2) of the Pub. Util. Code and Rule 14.6(c)(2) of the Commission's Rules of Practice and Procedure, the otherwise applicable 30-day period for public review and comment was shortened to 12 days. No comments or replies were filed.

Findings of Fact

1. Garrapata, a California corporation, is a Class D public utility water company regulated by the Commission.
2. Garrapata provides drinking water to approximately 49 non-metered residential service connections.
3. The Garrapata water system is currently operational.
4. The Garrapata water system has been operated by Cal-Am pursuant to a contract with Garrapata since June 2011.
5. Cal-Am is a Class A public utility water and sewer company regulated by the Commission.
6. Cal-Am is an experienced water and sewer system operator in Monterey County.
7. Garrapata and Cal-Am have entered into an Agreement pursuant to which Garrapata will sell, and Cal-Am will purchase, all of the assets that comprise the Garrapata water system.
8. Because there will be no change in the way Cal-Am utilizes the Garrapata assets after consummation of the proposed transaction no "direct or reasonably foreseeable indirect physical change in the environment" will occur as a result of the proposed transaction.

Conclusions of Law

1. In accordance with Commission practice, the SRF Loan from the California Department of Public Health currently held by Garrapata in the amount of approximately \$114,000 will not become a part of the rate base of the acquired assets.
2. In addition to the purchase price, Cal-Am will assume the SRF Loan from the California Department of Public Health currently held by Garrapata in the amount of approximately \$114,000.
3. Cal-Am's purchase of the Garrapata assets is not subject to the provisions of CEQA.
4. After the sale of the assets of the Garrapata water system, Cal-Am will assume the sole obligation of operating the system and providing public utility water service to the current customers in Garrapata's service territory.
5. Hearings are not necessary.

O R D E R**IT IS ORDERED** that:

1. The Garrapata Water Company may sell and the California-American Water Company may purchase the public utility assets of the Garrapata Water Company.
2. Upon conservation of the transaction the Garrapata Water Company is relieved of its public utility obligations.
3. The California-American Water Company's certificate of public convenience and necessity and service territory in Monterey County is expanded so that it may provide public utility water service to the current customers of the Garrapata Water Company.

4. The Garrapata Water Company's current rates for water service shall serve as the rates for the California-American Water Company's service to former Garrapata customers in Monterey County until its next general rate case.

5. The California-American Water Company shall, within 90 days of the issuance of this decision, file a tier 1 compliance advice letter incorporating the changes set forth in Ordering Paragraphs 3 and 4 above into its existing tariffs.

6. The rate base for the assets acquired from the Garrapata Water Company by the California-American Water Company shall consist of the cash price paid for the assets plus the transactional costs described herein that are associated with the acquisition.

7. The increase in rate base related to the transaction costs associated with the transfer of the public utility assets of the Garrapata Water Company shall not exceed the California-American Water Company's estimate.

8. The hearing determination is changed to no hearings are necessary.

9. Application 12-05-010 is closed.

This order is effective today.

Dated _____, at San Francisco, California.